

estimate total and the 1993 plant-in-service total (\$29,677) is not considered significant by the auditors since some plant placed in 1990 and 1991 may have been retired by 1993. However, the difference between these totals and the 1991 ARMIS Report amount is significant because it indicates an understatement of MemoryCall<sup>®</sup> investment of at least \$257,667, or 6.2 percent, as of the end of 1991. To the extent that this discrepancy was a result of the one month lag between the Company's Detailed Continuing Property Record ("DCPR") and CCS, it was corrected in January 1992. In any case, it is likely that complete reconciliation was effected in June 1992 in connection with the Company's annual true-up of central office equipment.

#### Cause

The cause of the input errors described above could not be specifically determined, but may be related to the fact that these were the first four MemoryCall<sup>®</sup> estimates to be processed by the Company.

#### Recommendations

In light of these findings, the auditors believe that special scrutiny should be afforded construction program activities related to nonregulated services. Since such activity makes up only a small portion of the total construction program, the unique coding required for nonregulated treatment can sometimes be overlooked. To provide a safety net to supplement SB efforts to maintain

accuracy in this highly sensitive area, the auditors recommend that both internal and external audits focus on this aspect of SB's construction program on a regular basis.

10. Right-To-Use fees should be directly assigned whenever possible.

#### Summary

During the audit period, MemoryCall<sup>2</sup> RTU fees were not directly charged to nonregulated, but were instead allocated on the basis of investment in the digital switching account. Although the CAM approved by the FCC in 1989 included a direct charge cost pool, this pool was not used for RTU fees prior to 1993. In 1993, the Company revised its systems and documentation to allow the direct charging of RTU fees. If a cost pool is listed in the Company's CAM, the FCC, the Commission and other interested parties have a right to assume the cost pool is used when appropriate.

#### Criteria

Part 64 of the FCC's rules states:

Costs shall be directly assigned to either regulated or nonregulated activities whenever possible.<sup>35</sup>

In conformance with this rule, MemoryCall<sup>2</sup> RTU fees, booked to Digital Electronic Switching Expense (Account 6212) should be directly assigned to nonregulated.

#### Condition

During its review of the four MemoryCall<sup>2</sup> estimates processed in 1990-1991, the auditors found that RTU fees were not being directly assigned to nonregulated. The Company confirmed that

---

<sup>35</sup>Code of Federal Regulations, Title 47, §64.901 (b)(2).

these expenses were being allocated based on the investment in Digital Electronic switching (Account 2212, 377C).

Further review revealed that the Company had established a "Direct Regulated/Nonregulated" cost pool in its CAM on June 30, 1989.<sup>36</sup> In early 1989, the FCC staff was working informally with telephone company personnel to guide them in the improvement of their CAMs. Although the Company contends that the FCC did not order it to establish a direct charge cost pool in Account 6212, this account was one of 14 which received new "Direct Regulated/Nonregulated" cost pools in the Company's June, 1989, CAM revision.

The Company did not, however, immediately revise its procedures to allow this cost pool to be used for the charging of RTU fees. From June 1989 through September 1991 this pool was used for the direct charging of Equal Access/Network Reconfiguration expenses to regulated. Effective October 1, 1991, the Company's CCS/PPS User Guide was changed to state that the "Direct Regulated/Nonregulated" cost pool (CP 01) was "not used".<sup>37</sup> The Company finally revised its systems and procedures to allow the direct charge cost pool to be used for RTU fees in 1993.

---

<sup>36</sup>See Appendix E, Table 7-4.

<sup>37</sup>See Appendix E, pp. 9.12.4 and 9.12.8. Note also that CP 99 as described on p. 9.12.1 contains investment leased to others and is assigned to regulated.

### Effect

Since the great majority of digital switching investment is classified as regulated, the allocation of Memory call RTU fees resulted in the overstatement of regulatory expense and the understatement of nonregulated expense. In estimate M1418, \$95,000 of RTU fees were so allocated instead of directly charged in 1990. The net effect of all RTU fee transactions during the audit period could not be determined, however, since direct charges to regulated might also have been made if the Company used CP 01.

Perhaps of greater significance than the amounts involved, however, is the fact that the Company listed in its CAM a direct charge cost pool which could not actually be used for RTU fees for over three years, and could not be used at all for over one year. If a cost pool is listed in a company's CAM, the FCC, the Commission and other interested parties have a right to assume that the cost pool is used when appropriate.

### Cause

The auditors were unable to determine why the "Direct Regulated/Nonregulated" cost pool was not used for RTU fees until 1993. The Company contends that its activation in 1993 was not related to the auditors' review of construction program activity.

### Recommendation

The auditors recommend that the Company ensure that its personnel are trained to directly assign RTU fees whenever

possible. The auditors also recommend that the Company not list any cost pool in its CAM which can not be used, unless this condition is fully disclosed in the CAM and the CCS/PPS User Guide.

11. The Commission should investigate the implications of a 1990 switch price restructure and increase its audit scrutiny of BellSouth to ensure that basic business and residential ratepayers are protected against cross-subsidies.

#### SUMMARY

A 1990 switch price restructure negotiated between BellSouth and AT&T<sup>38</sup> appears to have increased the costs assignable to noncompetitive services, e.g. POTS, call waiting, call forwarding, speed calling, etc., while reducing the costs assignable to competitive services, e.g. ESSX. The price restructure will have a direct impact on any current or future service cost studies reflecting switches purchased after the price restructure. Since the price restructure immediately preceded a major switch purchase, negotiated by BellSouth Services, a subsidiary of Southern Bell, the impact of these shifts are being incurred in addition to the fact that overall rate base and investment related costs are increasing.

AT&T's price restructure resulted in more of the total cost than would have been incurred prior to the restructure being absorbed by noncompetitive basic local exchange service and by noncompetitive discretionary services normally purchased by POTS customers. This was offset by lower incremental costs of competitive services (ESSX) after the restructure. The AT&T price restructure positioned BellSouth to subsidize future competitive services at the expense of increased costs to noncompetitive

---

<sup>38</sup>See Appendix F.

services.

The Commission should investigate whether BellSouth has taken an unfair competitive advantage of its monopoly position in favor of its ESSX service and all other competitive services at the expense of its monopoly customers. This investigation must also determine how the price restructure impacts current and future cost studies. The Commission should also increase its audit scrutiny of this Company to ensure that basic business and residential ratepayers are protected against cross-subsidies of any kind.

#### Criteria

Telecommunications companies in Georgia may not use current revenues earned or expenses incurred in conjunction with services subject to regulation to subsidize services which are not regulated or tariffed.<sup>39</sup> One of the objectives of this audit was to learn whether Southern Bell's regulated customers are protected from cross-subsidy. The Commission has defined cross-subsidy as any action undertaken by SBT which results in an understatement of intrastate regulated revenues or an overstatement of intrastate regulated expenses or investment for SBT.<sup>40</sup>

#### Condition

In 1990 AT&T restructured its switch and software prices. It appears that even after certain discounts were applied, the

---

<sup>39</sup>O.C.G.A Section 46-2-23(g).

<sup>40</sup>Docket No. 3987-U.



restructure created two basic cost shifts: (a) from direct expense (software) to capital cost (hardware and capitalized software), and (b) an inter-service shift from the competitive ESSX service to non-competitive residence and business service.

The first shift was accomplished by AT&T's regrouping of its software features to accommodate BellSouth's concerns regarding its most competitive lines of business. This shift decreased the price for the expensed (noncapitalized) software required to provide ESSX service with a partially offsetting increase to the price of the noncapitalized BRCS Universal software required to provide enhanced services such as call waiting, call forwarding, speed calling, etc. to monopoly residence and business customers.<sup>41</sup> The price decrease for ESSX software was so substantial that the overall total net price for feature (noncapitalized) software decreased.

AT&T's second shift increased hardware (capital) prices to recoup the overall reduction in software (expense) prices resulting from the decreased price for ESSX software. Specifically, AT&T increased the price for line cards so that the overall switch price remained revenue neutral. Line cards are required to provide dial tone and therefore are a fundamental component of the cost of monopoly service. Southern Bell properly notes that the price of line card units ("LCUs") decreased. LCUs are also a component of the cost of dial tone. Nevertheless, the line card price increase

---

<sup>41</sup>Prior to the price restructure BRCS I supported basic business and residence lines. Subsequent to the restructure, BRCS Universal contained four new services, i.e. cancel call waiting, call hold, automatic callback calling, distinctive ringing.

overwhelmed the LCU decrease.

BellSouth denies that there was a shift from expense to capital. AT&T, on the other hand, indicates that the expense-to-capital shift was the intent as well as result of the price restructure. AT&T contends that the restructure was "revenue neutral" to AT&T (i.e., total bottom-line switch and software revenue remained the same.)

BellSouth also maintains that the overall result of the price restructure and the subsequent negotiations was a net reduction in the per-line price of hardware and software. This net reduction appears to have resulted from increased discounts to BellSouth rather than from the price restructure. The restructured prices which are the subject of this finding were separate and apart from the additional discounts negotiated by the Company after the prices were restructured. Importantly, the Company acknowledges that even after discounts, the price of line cards increased.

The auditors note that Southern Bell "retained an unaffiliated third-party consulting/accounting firm to investigate this matter and to provide an unbiased expert opinion". According to the Company, that firm's conclusions apparently found "no merit in any of the auditors' allegations".

The auditors requested a copy of the third-party consulting/accounting firm's report in order to consider it in the development of our final opinion. The report in question is titled Bellsouth Telecommunications AT&T 5ESS Switch Procurement (1989-1991). It was prepared by Deloitte & Touche and transmitted to the

Company on March 9, 1994. The auditors have reviewed the Deloitte & Touche report and identified apparent technical flaws and inconsistencies.<sup>42</sup> The Company's representatives have been notified of these flaws and inconsistencies. The auditors have been informed that Deloitte & Touche stands behind its report. In general, the auditors believe that when the flaws are corrected, the Deloitte & Touche report corroborates the auditors' findings in this area.

### Effect

AT&T's price restructure is significant for many reasons. Immediately following the restructure, BellSouth made a commitment to purchase 86 new AT&T switches. Approximately 30 of the new switches were to replace existing switches in the Atlanta metropolitan area. AT&T's invoices reflecting the restructured prices determine BellSouth's accounting for the switch purchases. Therefore, the consequences of the price restructure are being incurred as the switches are placed in service and are reflected in any service cost study performed or to be performed subsequent to the price restructure.

The restructured prices resulted in cost shifts with

---

<sup>42</sup>For example, Appendix 4 of the report compares AT&T list prices as of 1989 with restructured 1991 prices. The 1989 prices, however, exclude BRCS II which comprises a majority of BRCS-ESSX at the restructured price. Another example is that the report appears to assume that BRCS 3 essentially became BRCS Extended ESSX (Centrex). This assumption is incorrect. The overwhelming majority of BRCS ESSX is from BRCS II prior to the restructure. The exclusion of BRCS II from any comparison of list prices pre and post restructure is inappropriate and misleading.

regulatory implications for BellSouth. The auditors determined this based on a review of (1) all relevant correspondence between the parties and internally within BellSouth dating from August 1989 to January 1991, (2) an April, 1990 AT&T presentation to BellSouth, (3) interviews with AT&T Network Systems and with a BellSouth officer and other BellSouth SMEs, and (4) discovery responses and price lists attached to contract 6700-B.<sup>43</sup> The auditors attempted to obtain from the Company, "surrogate cost studies" before and after the price restructure. However no such studies were available.

Since BRCS Universal software is purchased for all access lines, the average cost and incremental cost of a basic line increased as a result of this shift. The remaining portion of the ESSX software reduction was shifted to the cost of monopoly service by a direct increase to the cost of line cards. Line cards are required to provide dial tone and therefore are a fundamental component of the cost of monopoly service. Again, the average and incremental cost of a basic line increased. The incremental cost of BRCSs ESSX services declined significantly.

---

<sup>43</sup>The auditors attempted to review the contract PR-2774-B which first effected the price restructure. They were provided with a copy of contract PR-6700-B which went into effect January 1, 1992. All prices, with the exception of one, from AT&Ts April, 1990 presentation of the price restructure, were traced into contract PR-6700-B. The per line price for BRCS Universal was higher in contract PR-6700-B than as shown in AT&Ts presentation. The Company explained that the restructured price for this one item increased by 25 percent in the one year between contract PR-2774-B and PR-6700-B. Consequently, the original increase to the cost of basic residential and business service, increased yet further within one year.

BellSouth took advantage of the fact that its accounting is based on AT&T's invoices. BellSouth forced down AT&T's bid price for ESSX service without regard to AT&T's cost and did not object to the offsetting increases to AT&T's prices for hardware and software assignable to monopoly service.

AT&T's price restructure shifted cost from BellSouth's ESSX service category to its monopoly residence and business categories. This enabled BellSouth to increase the profit margins of its competitive service by shifting cost to its monopoly service. The increased profit margins could be used to reduce prices or alternatively to avoid price increases. The restructure also shifted cost from expense (ESSX software) to capital (rate base). These shifts are reflected in an increase to BellSouth's overall rate base resulting from the major switch purchase it made from AT&T. The shifts will also be reflected in any current or future cost studies which include switch and software costs at the restructured prices.

Under these circumstances AT&T's price restructure would result in more cost being absorbed by noncompetitive basic local exchange service and noncompetitive, discretionary services normally purchased by POTS customers, e.g. speed calling, call waiting, call forwarding, etc., offset with lower incremental costs for the competitive operations than would have been incurred prior to the restructure. The AT&T price restructure positioned BellSouth to subsidize future competitive services at the expense of increased costs to noncompetitive services. At the same time

total rate base was increasing due to BellSouth's major switch purchase from AT&T.

#### Cause

The AT&T price restructure was a national price restructure. Specifically, as it related to BellSouth, it appears that BellSouth used its purchasing power to achieve lower software costs assignable to its competitive customers because its Line of Business organization determined that those costs were too high for competitively marketing services in BellSouth. AT&T responded with lower directly assignable ESSX software costs and higher directly assignable non-competitive feature software and line card costs.

The correspondence and other documents reviewed by the auditors relating to this finding are attached as Appendix F. Certain significant documents are still in the Company's hands due to the proprietary agreement.

#### Recommendation

BellSouth used its purchasing power to obtain restructured prices which shifted BellSouth costs from competitive services to non-competitive monopoly services. BellSouth used the market power it possesses as a result of its virtual monopoly position in the local exchange market to achieve these results.

The Commission should investigate whether BellSouth has taken an unfair competitive advantage of its monopoly position in favor of its ESSX service and all other competitive services at the

expense of its monopoly customers. This investigation must also determine how the price restructure impacts current and future cost studies. The Commission should also increase its audit scrutiny of this Company to ensure that basic business and residential ratepayers are protected against cross-subsidies of any kind.

12. The inclusion of BellSouth Services' net income and equity in the Surveillance Report provided a subsidy for its nonregulated CPE products and masked the over-earnings on sales to the regulated operations.

#### Summary

BellSouth Services, Inc. ("BSS") was a nonregulated subsidiary that provided supplies and equipment to the BellSouth companies. As proposed by the Company, BSS's equity and net income were treated as regulated, i.e. above-the-line rate base and net income adjustments in the Rule NISI case. The Commission was not aware, however, that these BSS adjustments contained millions of dollars of obsolete nonregulated customer premises equipment ("CPE").<sup>44</sup> Since BSS's return on its CPE investment was significantly less than Southern Bell's allowed rate of return this resulted in a cross-subsidy to BSS's CPE operations.<sup>45</sup> The Commission was also not aware that the Company increased the add-back to its regulated rate base merely by relieving BSS of its liability for advances from other affiliates.

As a result of the inclusion of BSS's CPE investment and earnings in the Surveillance Report adjustments, the regulated telephone customers in Georgia were not protected from the

---

<sup>44</sup>The CPE was comprised of PBXs and Key Systems normally used by businesses. The inventory was continually written-down due to the tremendous technological advances in Customer Premises Equipment during this period, and subsequent changes in customer needs and preferences. The inventory write-downs were charged directly to nonregulated accounts on Southern Bell's books. Therefore, they did not reduce BSS's earnings. However, neither did they reduce the equity add-back to Southern Bell's rate base.

<sup>45</sup>See Appendix G.



excessive earnings BSS experienced on overpriced sales of other equipment to the regulated companies during the 1989 to 1991 time frame. Southern Bell's rate base is presently overstated as a result of purchasing overpriced products from BSS.

The auditors recommend a permanent \$19.152 million reduction to Southern Bell's rate base to eliminate the effect of the overpriced products included therein. The \$19.152 million amount is actually the cumulative CPE-related equity included as an add-back to Georgia's intrastate rate base by way of the BSS adjustments in the Surveillance Reports. Although the \$19.152 million represents the cumulative equity add-back, the auditors are recommending its use as a surrogate for the overpriced products included in the Company's rate base. The auditors also recommend that the Company be strongly reprimanded for its failure to inform the Commission that the BSS add-back included its unprofitable, obsolete, nonregulated business CPE line of business and for increasing the rate base add-back by relieving BSS of its liabilities to other affiliates.

#### Criteria

Georgia telecommunications companies may not use current revenues earned or expenses incurred in conjunction with services subject to regulation to subsidize services which are not regulated or tariffed.<sup>46</sup> One of the objectives of this audit was to determine if the Company's regulated customers are protected for

---

<sup>46</sup>O.C.G.A. Section 46-2-23(g).

cross-subsidy relating to the Company's nonregulated affiliates. The Commission has defined cross-subsidy as any action undertaken by SBT which results in an understatement of intrastate regulated revenues or an overstatement of intrastate regulated expenses or investment for SBT.<sup>47</sup>

The objective of this audit activity was to determine if BSS's equity, which was included in Georgia's rate base calculations, included Customer Premise (CPE- PBX and Key System) investment and if the return on that equity investment was being subsidized by over-charging for the equipment being sold to the telephone companies for regulated services.

#### Condition

BellSouth Services, Inc. ("BSS") was established as a nonregulated subsidiary to perform centralized purchasing functions and in turn sell supplies and equipment to the BellSouth companies. BSS was owned equally (50-50) by Southern Bell ("SB") and South Central Bell ("SCB"), i.e. BellSouth's two regulated entities. A majority of BSS's sales were to SB and SCB.

In the Rule NISI case (Docket No. 3905-U) SB proposed to treat BSS's net income and equity as ratemaking adjustments.<sup>48</sup> In other

---

<sup>47</sup>Docket No. 3987-U.

<sup>48</sup>This adjustment excluded a BSS subsidiary called BellSouth Products ("BSP").

words BSS was treated as if it was regulated.<sup>49</sup> The BSS adjustments were represented to the Commission as a method of protecting Georgia's regulated customers from excessive charges for purchases from BSS. However, the Company did not inform the Commission that it had transferred a substantial amount of obsolete business-CPE inventory into BSS and that those operations would be reflected in the add-back.

Prior to 1989, BSS's sales and operations primarily related to equipment and services typically used by SB's and SCB's regulated telephone operations. In 1989 two major CPE transfers were made to BSS.<sup>50</sup> One of these CPE transfers consisted of \$15 million in "Residence CPE" equipment. This investment was segregated into a separate subsidiary ("BSP") of BSS. The BSP earnings, losses and equity are adjusted out of the BSS add-back in Georgia's Surveillance Report.

Of greater importance was the second CPE transfer to BSS. This transfer directly impacted the BSS rate base and net income adjustments in Georgia's Surveillance Reports. This transfer, from BellSouth Advanced Systems, Inc. ("ASI"), consisted of nonregulated business CPE. These business CPE assets and liabilities were not put into a separate subsidiary company within BSS as was done with the residential CPE. The business CPE assets and liabilities were

---

<sup>49</sup>The auditors were informed that the BSS equity and net income was treated above-the-line in all BellSouth states.

<sup>50</sup>CPE was preemptively deregulated by the FCC in its 1980 Computer II decision, 77 FCC 2d 384.

combined with the existing regulated type equipment, masking the fact that nonregulated CPE investment was being included in the regulated rate base as part of the Rule NISI equity adjustment.

The business CPE inventory was apparently written-down immediately prior to being transferred into BSS and then further written-down several times due to tremendous technological advances in CPE during the audit period, and subsequent changes in customer's needs and preferences. Business CPE was an unprofitable line of business and never should have been added back to regulated operations. In the auditors' opinion, the Company cross-subsidized CPE through the BSS add-back and the internal tax subsidy described in Finding No. 3.

The business CPE transfer from ASI to BSS was comprised of the following: assets - [REDACTED] million, liabilities - [REDACTED] million, equity - \$55.9 million.<sup>51</sup> In March and April 1989, there were two additional equity infusions to BSS totaling \$50 million. These increased the equity amounts that were added to Georgia's rate base. Questions by the auditors concerning the additional \$50 million did not produce any journal entries which specifically identify BSS's accounting for these equity infusions.

The Company maintains that the equity infusions were used to reduce BSS's "Advances from Affiliates". Whether the \$50 million was used to reduce the \$39.8 million CPE liabilities or other

---

<sup>51</sup>It is the Company's position that this \$55.9 million of equity represented \$32.6 million of inventory and \$23.3 million of cash and cash equivalents, and therefore only CPE assets were \$32.6 million. The Company maintains that the \$23.3 million was utilized by all BSS operations. Figures redacted at Company request.

Advances from Affiliates, the result was a significant increase to Georgia's regulated rate base. The significance of this should be noted. BSS's advances from affiliates were directly added to the regulated rate base via Surveillance report adjustments.

In 1992, a majority of the BSS operations were reintegrated into the regulated operations of BST. At the same time, the CPE line of business was transferred to another nonregulated affiliate called BellSouth Communications Systems, Inc. ("BCS"). When the CPE assets were transferred from BSS to BCS, the transfer did not include the liabilities that originally had been transferred from ASI.

In July 1990, as a result of a FCC audit, BellSouth made a \$5.6 million interstate refund for 1989 overcharges. From the documents reviewed, it appears that the FCC's staff was not aware that BSS's operations included the mixing of CPE assets with regulated type investment sales, when they agreed to the refund amount. Also the impact of CPE equipment was not considered in their evaluation of 1990 and 1991 BSS's charges and rate-of-return evaluations. Furthermore, the FCC did not allow the BSS add-back the Companies used for their intrastate regulated operations. None of the 1990 refund was funnelled to intrastate operations.

The auditors' evaluated BSS's net income earnings for the 1989 - 1991<sup>52</sup> period by product group (regulated and nonregulated business CPE) and the equity included in the rate base for each.

---

<sup>52</sup>1989 to 1991 was considered to be relevant since it reflects the period that the CPE operation was included in BSS.

The combined earnings for both product groups was 18.3 percent in 1989. This was significantly greater than Georgia's allowed rate of return. The three year combined average return on equity was 13.6 percent. This 13.6 percent return on total BSS equity was a combination of a 18.0 percent return on regulated equity and a 4.3 percent return on business CPE equity.<sup>53</sup> The auditors have concluded that the combining of the CPE equity and net income into the regulated operations Surveillance Reports adjustments resulted in a cross-subsidy for BellSouth's CPE operations (Appendix G).

Even without considering the \$50 million equity infusion, the combined amount of CPE equity, included in Georgia's Intrastate Rate Base for the 1989, 1990 and 1991 Surveillance Reports was \$19.152 million.

#### Effect

The auditors have concluded that the combining of the CPE equity and net income into the regulated Surveillance Report's adjustments resulted in a cross-subsidy of BellSouth's CPE operations. The "form" was that the regulated ratepayers would be protected from the actions of the nonregulated companies, when in reality the "substance" is that they were actually harmed.

---

<sup>53</sup>The Company was asked to provide calculations such as these but declined. It maintains that "Any calculation by the auditors that purports to show that BSS earned a different return on its investment in CPE as opposed to the other services it provided is simply incorrect." The auditors disagree, but have supplied their calculation to the Company for any corrections. None have been provided.

### Cause

Regulated and nonregulated investments were commingled at BSS and included as a BSS's equity and net income (less BSP) Surveillance Report adjustments. These adjustments were proposed by the Company and represented as a method of protecting Georgia customers from paying too much for BellSouth affiliate purchases. In reality, the inclusion of the unprofitable CPE operations in BSS masked significant overcharges for equipment purchases that were charged to regulated ratepayers and included in the current regulated rate base as telephone plant in service. This overcharging resulted in cross-subsidy for the BSS CPE operations. When the Company proposed including BSS's equity and net income as Surveillance Report adjustments, it failed to mention to the Georgia Commission that the adjustments included millions of dollars of obsolete nonregulated CPE investment.

### Recommendation

The auditors recommend a permanent \$19.152 million Surveillance Report rate base reduction to eliminate the effect of the overpriced products included therein. The auditors also recommend that the Company be strongly reprimanded for its failure to inform the Commission that the BSS add-back proposed by the Company included unprofitable, obsolete, nonregulated business CPE and also for increasing the rate base add-back by relieving BSS of its liabilities to other affiliates.

13. The calculation and booking process used to record transfers of equipment between regulated companies should be mechanized to prevent errors.

#### Summary

The objective of the audit review of this function was to verify that assets (predominately central office Plug-In equipment) are being properly accounted for in transfers between state jurisdictions. The audit verified that Southern Bell's investment accounting process for the equipment transfers and inventory controls are proper and that the depreciation reserve calculation process which is used by the Company follows the affiliated transaction rules. The only negative item noted during the evaluation was that the net book salvage calculation process used by the Company is a manual operation, utilizing interstate reserve factors which may be as much as 18 months old. The manual process is labor intensive and could potentially result in errors, even though none were detected in the data reviewed. The auditors recommend that the calculation and booking process be mechanized to reduce manual effort and time delays. Southern Bell indicates that the calculation and booking process is tentatively scheduled to be mechanized by February 1995. Since the Company has plans for a system which will address the audit's concerns, no further action is required in this area.

#### Criteria

The audit determined that junking, scrap, salvage sales and



transfers are tracked individually within the warehouse and accounted for using a shipping invoice procedure. The audit verified that appropriate forms are being produced within the warehouse locations, so that the individual units of equipment and the associated investment can be tracked. Once the net book values are calculated, the salvage entries are then mechanically processed from that data so that appropriate salvage credits are received by each state for transfers. One objective of this review was to verify that the assets (predominately central office Plug-In equipment) being accounted for in transfers between regulated state jurisdictions is transferred (sold) at its net book value, per the FCC Part 32 rules for affiliate transactions. The data analyzed in the audit indicates that Southern Bell is correctly following the rules governing the transfer of regulated assets from one jurisdiction to another by using a manual process to calculate the net book values and resulting investment transfer amounts.

#### Condition/Effect

A review of the mechanized entries from the PICS/DCPR system indicates that as units are transferred from one jurisdiction to another, a retirement is processed in the state from which it is being transferred. A salvage entry is also processed, which is based on a calculated net book value using depreciation reserve tables that are provided by the Company's depreciation organization. These reserve tables are produced in about July using the previous end-of-year data. At times, therefore, the